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No. 796

In the Supreme Court of the United States

October Term, 1952

[redacted]

Petitioner,

v.

[redacted]

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENTS AND MOTION TO DISMISS OR AFFIRM

[redacted]

[redacted]
Solicitor General,
Department of Justice,
Washington 25, D.C.

[redacted]
Assistant Attorneys General,

[redacted]
Attorneys,

[redacted]
Special Assistant to the Attorney General,
Attorneys for Respondents.

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 798

W. D. YORK, PETITIONER

v.

FLORIDA SOUTHERN CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION[1]

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 23–26) is reported at 310 F. 2d 109. The district court rendered no opinion; the orders appealed from (R. 42–46)[2] contain its findings.

JURISDICTION

The judgment of the court of appeals (Pet. App. 27–28) was entered on November 28, 1962, and a petition for rehearing was denied on December 27, 1962

[1] The Securities and Exchange Commission is a party to the reorganization in the district court pursuant to Section 208 of the Bankruptcy Act (11 U.S.C. 608), and participated as an appellee in the court of appeals.

[2] "R.—" refers to the printed record in the court of appeals.

(Pet. App. 29). The petition for a writ of certiorari was filed on February 7, 1963. The jurisdiction of this Court is invoked under 11 U.S.C. 47 and 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the district court abused its discretion in holding that the debtor's petition for reorganization under Chapter X of the Bankruptcy Act was filed in good faith, where the holders of the senior mortgages had stated that they would reject any plan of reorganization but the court determined that the debtor's property was worth substantially more than the amount of the mortgages.

STATUTE INVOLVED

Section 144 of Chapter X of the Bankruptcy Act, 52 Stat. 887, 11 U.S.C. 544, provides:

> If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 146([redacted] of Chapter X of the Bankruptcy Act, 52 Stat. 887, 11 U.S.C. 546(3) provides:

> Without limiting the generality of the mean-

ing of the term "good faith," a petition shall be deemed not to be filed in good faith if—

* * * * * *

(3) it is unreasonable to expect that a plan of reorganization can be effected; * * *

STATEMENT

Florida Southern Corporation (the "debtor") filed a petition for its reorganization under Chapter X of the Bankruptcy Act in the United States District Court for the Southern District of Florida on May 17, 1962 (R. 6–33). The debtor owns a 100 room luxury resort hotel and related facilities and structures, as well as a real estate development of about 325 acres, all located on Duck Key, one of the Florida Keys (R. 17–19). Its stock is publicly held (Pet. App. 23). The hotel was opened early in 1960, but operations were interrupted in the latter part of that year as a result of substantial hurricane damage (R. 90).

An unaudited balance sheet as of April 30, 1962, attached to the petition, showed total assets of almost six million dollars. The hotel, furnishings and related structures, and facilities were shown at depreciated cost of more than three million dollars, and the real estate holdings were stated at approximately two and a half million dollars (R. 14). Stated liabilities as of the same date totaled approximately $2,700,000, including the first and second mortgages in principal amounts of $1,100,000 and $600,000, respectively, and a third mortgage in principal amount of about $42,000 (R. 15). The first mortgage, executed on May 19, 1961, provided for 6½ percent interest in the first

year and an annual rate of 15 percent thereafter (R. 21, 22). The second mortgage, executed on the same date, bore 6 percent interest and matured one year thereafter (R. 21). This mortgage was originally held by the contractor who did the restoration work on the hotel after the hurricane and was subsequently purchased by the second mortgagee (R. 21, 23). The balance sheet showed $36,000 of interest payable on this mortgage (R. 15, 21).

Petitioner, the holder of the second mortgage, and the first mortgagee filed answers (R. 34–42) in which they stated that they would not approve any plan of reorganization (R. 35, 41), and urged that the petition be dismissed as not filed in "good faith" within the meaning of Chapter X because it was unreasonable to expect that a plan of reorganization could be effected (R. 35–36, 41). After a hearing at which testimony and documentary evidence was introduced (R. 48–139), the district court refused to dismiss the petition for lack of good faith (R. 42–43), and subsequently approved it (R. 43–45). The court found that the value of the debtor's property was substantially in excess of its secured indebtedness; that the mortgage holders were fully protected as to both the principal and interest of their claims; and that foreclosure would extinguish the debtor's equity in the property and preclude any possibility of recovery by the debtor's unsecured creditors or stockholders (R. 44).

On appeal by the second mortgagee (R. 45–46, 140), the court of appeals affirmed (Pet. App. 23–26). The court held that the announcement by a class of se-

cured creditors that it will not agree to a reorganization plan does not make it "impossible for a Chapter X reorganization petition to be filed in 'good faith'" (Pet. App. 24). The court ruled that neither the district court's determination that the property "was worth substantially more than the mortgages" nor its conclusion that the petition was, in such circumstances, filed in good faith, was clearly erroneous (Pet. App. 25). The court, however, "suggest[ed] that the trial court expedite in every way possible its determination whether there is reasonable likelihood that a reorganization can be accomplished" (Pet. App. 26).

ARGUMENT

This case presents only the narrow question whether, in the circumstances here involved, the district court was warranted in concluding that the petition for reorganization was filed in good faith. That conclusion turns primarily upon the facts of the particular case, is in accord with the controlling decisions, and presents no issue warranting further review.

Section 144 of Chapter X provides that the district judge shall approve a petition for reorganization, after material allegations of the petition have been controverted, if satisfied that it is filed in "good faith," and Section 146(3) provides that a petition is not filed in good faith if "it is unreasonable to expect that a plan of reorganization can be effected." The district court, after a hearing at which conflicting valuation testimony was presented, found that the debtor's property was worth substantially more than the amount of the mortgages, and the court of appeals

upheld the finding. The mere fact that the holders of the senior mortgages had announced in advance that they would not approve any plan of reorganization does not preclude a finding of good faith. *In re East Boston Coal Co.*, 30 F. Supp. 811 (M.D. Pa.); *In re Schafer's Bakeries*, 129 F. Supp. 82 (E.D. Mich.); *In re 263 West 38th Street Corporation*, 37 F. Supp. 667 (S.D. N.Y.); *In the Matter of New Centre Apartment Hotel, Inc.*, Bankruptcy No. 49634, E.D. Mich., July 3, 1962.[*] See *In re Castle Beach Apartments, Inc.*, 113 F. 2d 762, 764 (C.A. 2); *White* v. *Peñalas Mining Co.*, 105 F. 2d 726, 729 (C.A. 9). See also 6 Collier on *Bankruptcy*, Par. 6.09, at p. 1782 (14th ed. 1947). For as long as the debtor's assets appear, upon a preliminary examination, to exceed the valuation of the claimants opposing any reorganization, it is not "unreasonable to expect that a plan of reorganization can be effected" despite their opposition.

This is so for two reasons. *First*, a creditor, despite his initial objection, may change his mind when presented with a specific plan and conclude that its acceptance is in his best interest. *Second*, a plan of reorganization may be accepted over the opposition of a class of creditors, if it provides for payment of the claims of objecting senior creditors in cash or its "indubitable equivalent." See Section 216(7) of Chapter X of the Bankruptcy Act (11 U.S.C. 616(7)) and *In re Murel Holding Corp.*, 75 F. 2d 941, 942 (C.A. 2).

[*] The opinion in the *New Centre* case is unreported. A copy is set forth in the Appendix, *infra*.

Contrary to petitioner's argument, the ruling below on this issue is not in conflict with *Fidelity Assurance Association* v. *Sims*, 318 U.S. 608. In that case it was conceded that the debtor was insolvent, and this Court held that a petition for reorganization was not filed in good faith where its purpose was merely to obtain an orderly liquidation of the debtor. In the present case, on the other hand, the district court found that the value of the debtor's assets substantially exceeded its mortgage indebtedness, and it did not find that the purpose of the reorganization was to liquidate the company.

While the decision below appears contrary to two earlier decisions of the Court of Appeals for the Fourth Circuit (*In the Matter of National Development Corporation*, 261 F. 2d 13, and *Arey & Russell Lumber Company* v. *American National Bank & Trust Company*, 201 F. 2d 508), those decisions are no longer significant in view of that court's later decision in *Janaf Shopping Center, Inc.* v. *Chase Manhattan Bank*, 282 F. 2d 211. In the *Janaf* case the district court had found an absence of good faith solely because of the announced opposition of the first and second mortgagees to any reorganization. The court of appeals, after referring to its *National Development* and *Arey & Russell* cases, stated that the announced opposition of the senior creditors "is not itself necessarily determinative of the question," but it affirmed the district court on the ground there was "an abundance of circumstances" showing that there

was "no reasonable prospect for any plan to succeed" 282 F. 2d at 215. Since the *Janaf* case has thus in effect overruled the *National Development* and *Arey & Russell* cases, there is no need to resolve the alleged conflict between those cases and the present case.

Although the record before the district court would have been insufficient for a determination of valuation upon which to predicate a reorganization, the courts have acknowledged the essentially tentative character of a "good faith" finding. It merely reflects the judge's determination that "a reasonable opportunity" should be given "to effect a reorganization plan which would conceivably be of benefit to all of the creditors and to the estate" and which appears reasonably possible. *In the matter of New Centre Apartment Hotel, Inc.*, Bankruptcy No. 49634, E.D. Mich., July 3, 1962, *infra*, p. 11; see also *R. L. Witters Associates, Inc.* v. *Ebsary Gypsum Co.*, 93 F. 2d 746, 748–749 (C.A. 5); *In re Castle Beach Apartments, Inc.*, 113 F. 2d 762–763 (C.A. 2); *White* v. *Penelas Mining Co.*, 105 F. 2d 726, 729 (C.A. 9). Chapter X recognizes that, despite the initial determination that a successful plan may reasonably be anticipated, no plan may ever be effected, and the reorganization may have to be dismissed and the debtor liquidated. Section 169 (11 U.S.C. 569) makes it the duty of the trustees to prepare a plan or "a report of his reasons why a plan cannot be effected," and Section 236 (11 U.S.C. 636) authorizes the court to dismiss the Chapter X proceeding if, within the time specified by it, no plan is proposed, accepted or consummated. Since it here appeared that a reorganization may preserve the debtor's going-concern

value so as to permit participation in the reorganized corporation by interests junior to those opposing the petition, the district court properly permitted the trustee to explore the possibilities of effecting a reorganization. Cf. *In re Julius Rochrs Co.*, 115 F. 2d 723, 724 (C.A. 3).

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

PETER A. DAMMANN,
General Counsel,
DAVID FERBER,
Associate General Counsel,
ROBERT W. COX,
Attorney,
Securities and Exchange Commission.

MARCH 1963.

APPENDIX

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION

BANKRUPTCY NO. 49634

IN THE MATTER OF.
NEW CENTRE APARTMENT HOTEL, INC., DEBTOR

OPINION ON PETITION FOR REORGANIZATION

This matter came before the Court on a petition filed by two creditors of the debtor, for a reorganization under Chapter X of the Bankruptcy Act. The lone secured creditor and certain unsecured creditors filed answers in opposition thereto. The debtor filed an appearance but no answer to the petition.

After proper notice to the creditors and stockholders a hearing was held on the petition and briefs were submitted by the interested parties. The respondent creditors claim the petitioners have not shown that the petition was filed "in good faith" within the meaning of Sec. 1146 of the Bankruptcy Act since the secured creditor has stated unequivocably in its answer that it will not accept any plan which modifies its interest in the premises and no plan can be affected without its consent.

The same objection was made in the case of *In re Shafer's Bakeries*, 129 F. Supp. 82, in which Judge Freeman said, quoting *In re Julius Roehrs Co.*, 3 Cir. 115 F. 2d 723, 724:

> * * * it was not the duty of the court to ascertain whether or not a particular plan of reorganization could be carried out but only whether it was reasonable to expect that a plan of reorganization could be effected; that there was opportunity and need for reorganization and that the petition was filed with the honest intention of effecting it and not for the purpose of hindering and delaying creditors."

Respondent creditors contend that the factual situation was different in that case since a Trustee under Chapter X had already been appointed, a time set for filing a plan, which time had not yet elapsed. This Court cannot agree that this change in the factual situation materially alters the logic of the Court's findings of law, which this Court adopts and holds equally applicable to the present case.

The Court cannot see that material harm can come to the creditors or to the debtor estate if a reasonable opportunity is given to the petitioning creditors to effect a reorganization plan which would conceivably be of benefit to all the creditors and to the estate. Accordingly petitioners are requested to present to this Court within seven (7) days hereof an order approving the petition. When the order presented, the Court will consider the naming of the Trustee, the bond to be required of him, the time within which he is to report to the Court on a proposed plan for corporate reorganization, and such other matters as are incident to the granting of the Order.

THADDEUS M. MACHROWICZ,
U.S. District Judge.

DATED AT DETROIT, MICHIGAN, THIS 3RD DAY OF JULY, 1962.

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